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Central Bank of Kenya

Twenty Sixth Bi-Annual Report of the Monetary Policy Committee

April 2021



LETTER OF TRANSMITTAL

In accordance with Section 4D of the Central Bank of Kenya Act, it is my pleasure to present to you, Honourable Cabinet Secretary of the National Treasury and Planning, the 26th Monetary Policy Committee Report. The Report outlines the monetary policy formulation, developments in the key indicators of the economy, and other activities of the Committee in the six months to April 2021.

Patrick Njoroge

Dr. Patrick Njoroge

Governor

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Mrs. Sheila M'Mbijewe
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Dr. Benson Ateng'
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Mr. Raphael O. Otieno
Acting Director, Research

EXECUTIVE SUMMARY

The twenty sixth bi-annual Report of the Monetary Policy Committee (MPC) reviews Kenya's monetary policy formulation and other developments in the economy during the six months to April 2021. Consistent with the price stability objective of the Central Bank of Kenya (CBK), the conduct of monetary policy during the period aimed at maintaining overall inflation within the target range of 2.5 percent on either side of the 5 percent medium-term target. Monetary policy was conducted in the context of the continuing global COVID-19 (coronavirus) pandemic, the measures taken by authorities around the world to contain its spread and impact, and the rollout of vaccination programmes.

The MPC held three meetings in the period November 2020 to April 2021, to review economic developments and to assess the outcomes of its policy measures deployed since March 2020 to mitigate the adverse economic effects and financial disruptions of COVID-19. The MPC also closely monitored the impact of the various measures implemented by the Government to mitigate the effects of the pandemic. The Committee maintained an accommodative monetary policy stance throughout the period. In this regard, the MPC retained the Central Bank Rate (CBR) at 7.00 percent during the period. The package of policy measures implemented since March 2020 protected the economy from any substantial decline, and supported the most vulnerable citizens. The monetary policy stance together with CBK liquidity management ensured both price and market stability.

Overall inflation remained anchored within the target range during the period, supported by lower food prices and muted demand pressures. The 12-month inflation rate stood at 5.8 percent in April 2021 compared to 4.8 percent in October 2020, largely due to higher fuel prices, and the mild impact of tax relief reversals in January 2021. Non-food-non-fuel inflation remained low and stable below 5 percent, reflecting muted demand pressures in the economy.

The foreign exchange market remained stable, supported by a narrowing current account deficit and

balanced flows. The current account deficit narrowed to 5.2 percent of GDP in the 12 months to April 2021 compared to 5.6 percent in April 2020. This narrowing reflected resilient exports particularly of horticulture, strong diaspora remittances and a lower oil import bill. The CBK foreign exchange reserves, which stood at USD 7,628 million (4.69 months of import cover) at the end of April 2021, continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

The economy recovered in the fourth quarter of 2020 and first quarter of 2021, supported largely by strong performance of agriculture, construction, real estate, finance and insurance, and the wholesale and retail trade. Private sector optimism on economic prospects in 2021 remained strong on account of the rollout of COVID-19 vaccines, the stable economic environment, increased Government spending on infrastructure, as well as the COVID-19 mitigation measures. Additionally, the approval of the Extended Credit Facility (ECF) and Extended Fund Facility (EFF) Arrangements by the International Monetary Fund (IMF), on April 2, 2021, underscored confidence in the country's macroeconomic policies.

The banking sector remained stable and resilient during the period, with strong liquidity and capital adequacy ratios. The ratio of gross non-performing loans (NPLs) to gross loans stood at 14.2 percent in April. Banks continued to make appropriate provisions for NPLs. Private sector credit growth remained resilient, supported by the accommodative monetary policy stance and demand resulting from improved economic activity. Growth in credit to the private sector stood at 9.7 percent in the 12 months to February 2021 and 6.8 percent in April, with significant repayments and recoveries in March and April.

The CBK continued to monitor the implementation of the emergency measures announced on March 18, 2020, while ensuring that the interbank market and liquidity management across the sector continued to function smoothly. These measures provided the

intended relief to borrowers, supported continued operation of businesses in essential sectors, and mitigated against severe loss of jobs and livelihoods. The measures also provided space for the banking sector to build capital and liquidity buffers, thereby strengthening resilience of the sector.

The MPC held virtual meetings with stakeholders in the financial and real sectors following every MPC meeting to provide the background to its decisions and obtain feedback. Post-MPC media briefings by the Governor provided the basis for policy decisions, and updates on the economy. The meetings continued to improve the understanding of the conduct of monetary policy.

The Bank continues to monitor and remains vigilant with respect to the risks posed by developments in the domestic and global environments, particularly the evolving COVID-19 pandemic and ongoing vaccination programmes, on the economy and the overall price stability objective.

1. DEVELOPMENTS IN THE GLOBAL ECONOMY

The global economic outlook has improved, but remains highly uncertain due to the the COVID-19 pandemic. According to the IMF's April 2021 World Economic Outlook (WEO), the global economy contracted by 3.3 percent in 2020, but is expected to expand by 6.0 percent in 2021. The expected improvement in global output is due to additional fiscal support in some major economies, as well as a vaccine-driven recovery expected in the second half of 2021.

Growth in the advanced economies was expected to reach 5.1 percent in 2021, but there is substantial divergence in the region's growth recovery direction. Growth in the US and Japan is expected to return to pre-pandemic levels in the second half of 2021. Growth in advanced economies is expected to recover in 2021 as follows: United States (6.4 percent), the United Kingdom (5.3 percent), Japan (3.3 percent), Spain (6.4 percent), France (5.8 percent), Italy (4.2 percent), and Germany (3.6 percent).

Growth in emerging market and developing economies is expected to accelerate to 6.7 percent in 2021. As a result of successful containment measures, aggressive public spending, and central bank liquidity support,

output in China is projected to expand by 8.4 percent in 2021. Latin America's growth is projected to pick up to 6.4 percent, with growth for Brazil and Mexico forecasted at 3.7 percent and 5.0 percent, respectively. Emerging Asia growth rates were revised upwards due to a stronger recovery following easing of lockdown restrictions in some of the large countries such as India.

Output in Sub-Saharan Africa (SSA) is expected to increase by 3.4 percent in 2021, which is significantly lower than the pre-pandemic trend, with tourism-dependent economies being particularly hard hit. Growth in Nigeria and South Africa is projected to improve to 2.5 percent and 3.1 percent, respectively.

The downside risks remain significant particularly escalation of the pandemic, emergence of new strains, and operational threats such as vaccine development and delivery delays. Additionally, financial conditions that entail a re-evaluation of market dynamics, a rise in core sovereign yields, and a re-evaluation of inflation risks may all result in a rapid repricing of financial assets.

2. DEVELOPMENTS IN THE KENYAN ECONOMY

2.1 Overall Economy

The economy began to recover in the second half of 2020, as economic activity picked up following easing of various containment measures instituted by the Government to mitigate the spread of the COVID-19 pandemic. In the third quarter of 2020, real GDP contracted by 1.1 percent, a significant improvement compared to the second quarter, but low compared to the 5.8 percent growth realised in the third quarter of 2019. Growth in the third quarter of 2020 was largely supported by strong performance of agriculture and construction sectors, which grew by 6.3 percent and 16.2 percent, respectively. The services sector recorded a contraction of 5.3 percent in the third quarter of 2020, which was an improvement compared to a contraction of 11.7 percent in the second quarter, but significantly lower than the 6.7 percent growth in the same quarter of 2019. The easing of domestic and international COVID-19 containment measures led to a pick-up in activity in sectors such as transport and storage (2.9 percent), information and communication (7.3 percent) and real estate (5.3 percent). However, recovery remained slow in sectors such as accommodation and restaurant (-57.9 percent), education (-41.9 percent) and wholesale and retail trade (-2.5 percent).

Leading Economic Indicators for the fourth quarter of 2020, and first quarter of 2021 point to a strong recovery in industrial activity from the adverse impact of the COVID-19 pandemic, and continued strong performance of the agriculture sector. As a result, the economy is expected to record a modest positive overall growth rate in 2020, with the positive performance of the first and fourth quarters counterbalancing the contractions recorded in the second and third quarters.

The main upside risks to growth were the coordinated domestic and international interventions to mitigate the negative impact of COVID-19, and continued implementation of a wide range of measures by the Government to cushion the economy against the adverse effects of COVID-19. Moreover, the availability and distribution of vaccines could hasten the normalisation of domestic and global economic

activity. However, the downside risks to growth remain significant, including any protracted waves of infections leading to widespread and prolonged lockdowns both domestically and globally, uneven recovery within the global economy, and rising international oil prices.

2.2 Financial Markets Developments

According to the IMF April 2021 Global Financial Stability Report, global financial conditions remained broadly supportive reflecting extraordinary policy support measures across countries to mitigate the impact of the COVID-19 pandemic. Interest rates remained low, although longer-term interest rates particularly in the U.S. have risen in the recent past on improved prospects for a pick up in inflation and growth. Equity markets have rallied aggressively since the third quarter of 2020 on expectations of a rapid economic recovery and continued policy backstops. However, asset valuations are somewhat stretched in some segments and financial vulnerabilities have increased in some sectors.

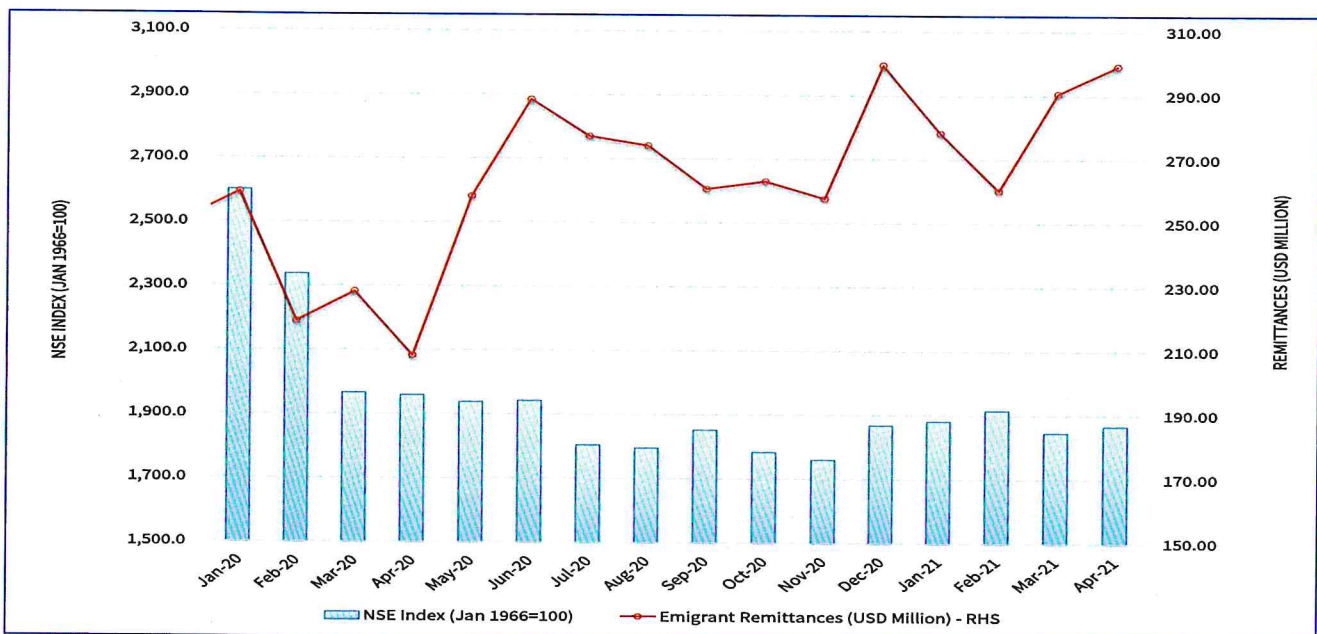
Among major currencies, the U.S. Dollar weakened against most developed market currencies due to improvements in global growth outlook despite inflationary pressures and a resurgence of COVID-19 in parts of the world. Currencies of major emerging market economies gained against the US dollar despite some notable turbulence in early 2021 on the back of rising interest rates in the U.S.

In the domestic economy, diaspora remittances remained resilient; with the monthly inflows increasing to USD 299.3 million in April 2021 from USD 263.1 million and USD 208.2 million in October and April 2020, respectively. The growth and resilience of remittances was largely supported by fiscal stimulus in host countries and financial innovations which provided Kenyans in the diaspora more convenient channels for transactions.

Trading of equities at the Nairobi Securities Exchange (NSE) rebounded in April 2021 compared to October 2020, reflecting improved investor confidence on reopening of the economy and gradual inflow of foreign investments. The NSE 20-Share index gained 4.6 percent from 1,783.7 points in October 2020 to 1,866.6 points in April 2021 (**Chart 1a**). Market capitalization improved while the number of shares traded and total equities turnover declined. The share of foreign investors trading to total equity turnover declined to an average of 62.6 percent in the six months to April 2021 from an average of 66.4 percent in six months to October 2020. In the domestic secondary bond market, bonds turnover decreased by 5.8 percent to KSh 373.6 billion from KSh 396.6 billion in the six months to October 2020.

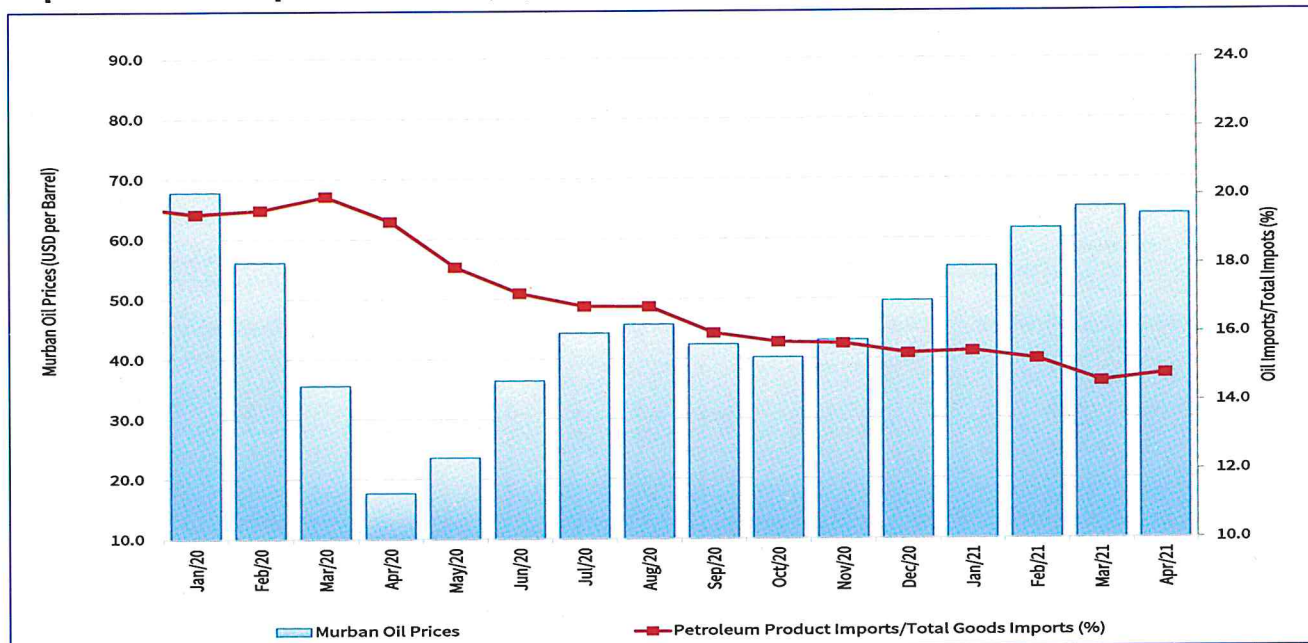
Developments in international oil prices have implications on the balance of payments position particularly when the proportion of imports of petroleum products in total imports is high. Murban crude oil price increased to USD 63.9 per barrel in April 2021 from USD 40.2 per barrel in October 2020 and USD 17.6 per barrel in April 2020. This reflects gradual re-opening of economies, relaxation of COVID-19 restrictions and increased demand. However, the proportion of imports of petroleum products in total imports of goods declined to 14.8 percent in April 2021 from 15.7 percent in October 2020, in part reflecting the recovery of total imports (**Chart 1b**).

Chart 1a: Monthly Diaspora Remittances (USD Million) and NSE Index (Jan 1966=100)



Source: Central Bank of Kenya and Nairobi Securities Exchange

Chart 1b: Murban Oil Prices and the Ratio of 12-Month Cumulative Petroleum Products Imports to Total Imports of Goods (%)



Source: Abu Dhabi National Oil Company and Kenya Revenue Authority

2.3 Developments in Key Economic Indicators

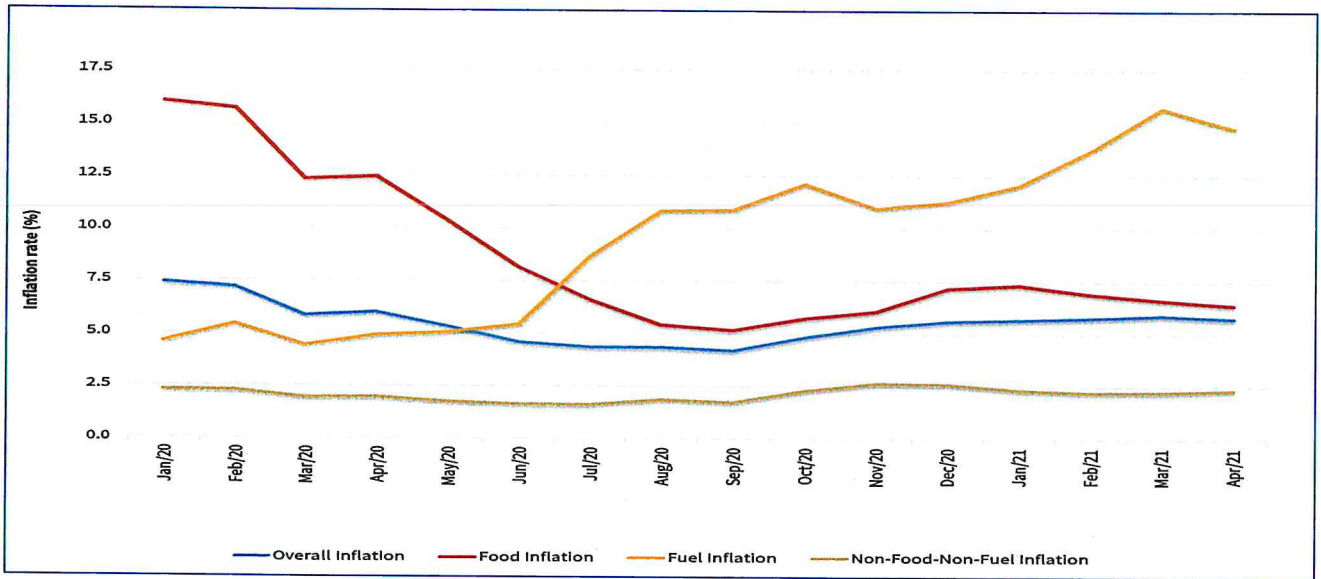
2.3.1 Inflation

Overall inflation remained within the target range during the six months to April 2021. The overall inflation rate increased to 5.8 percent in April 2021 from 4.8 percent in October 2020, driven mainly by higher fuel prices. Fuel inflation increased to 14.8 percent in April from 12.2 percent in October, driven by pump price adjustments and continued social distancing measures in the transport sector. The cancellation of pump price increases by EPRA in April moderated the fuel inflation

push. Food inflation increased to 6.4 percent in April 2021 from 5.8 percent in October 2020, reflective of the mild impact of the VAT adjustment on some non-vegetable food items. Non-food-non-fuel (NFNF) inflation remained low, reflective of muted demand pressures in the economy. It declined to 2.4 percent from 2.7 percent in November (**Charts 2a**). Inflation rates of all consumer good categories except Transport and Electricity, Gas and other Fuels were within the target range in April 2021 (**Chart 2b**).

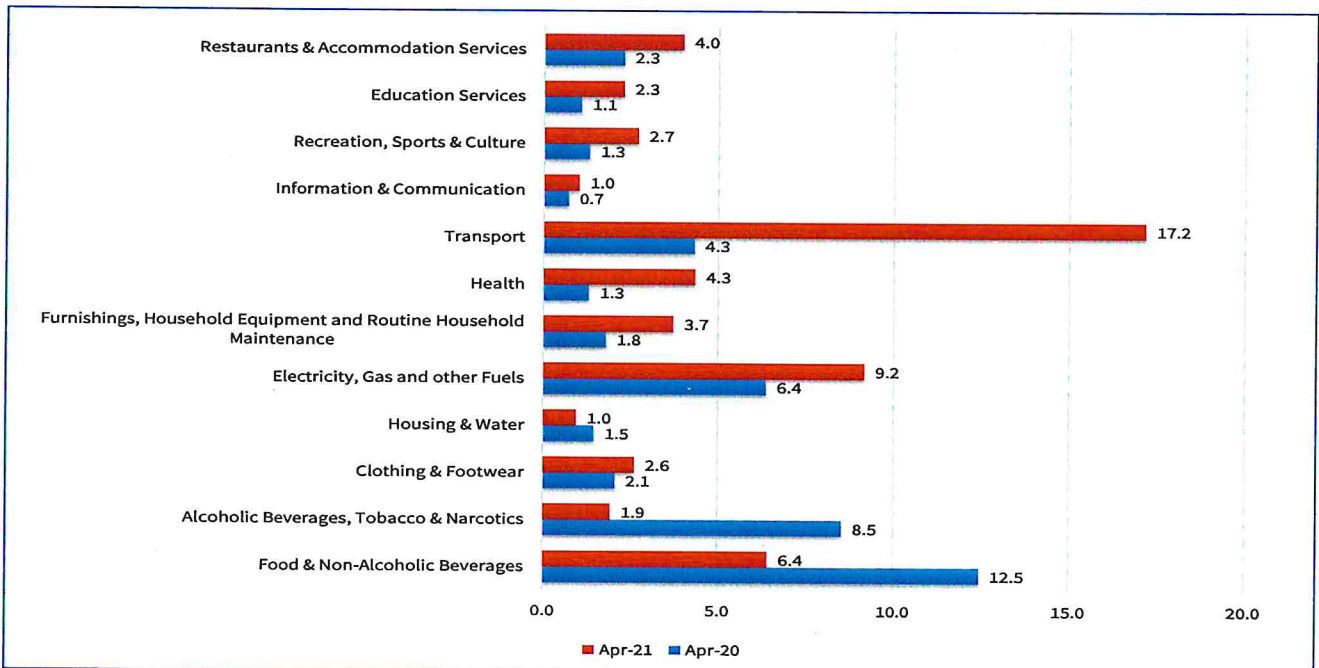
Inflation rates for countries in the region remained relatively stable during the period (**Chart 2c**).

Chart 2a: Overall and Non-Food Non-Fuel Inflation(%)



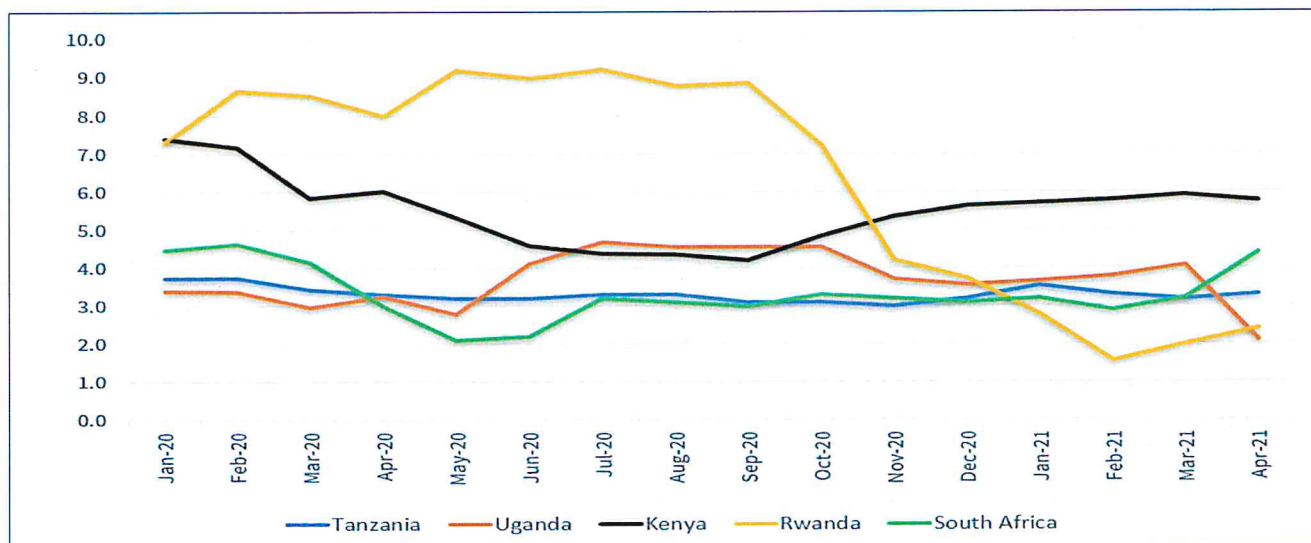
Source: Kenya National Bureau of Statistics and Central Bank of Kenya

Chart 2b: 12-Month Inflation by Broad CPI Category (%)



Source: Kenya National Bureau of Statistics

Chart 2c: 12-Month Inflation in the Region (%)



Source: Kenya National Bureau of Statistics and Central Bank of Kenya

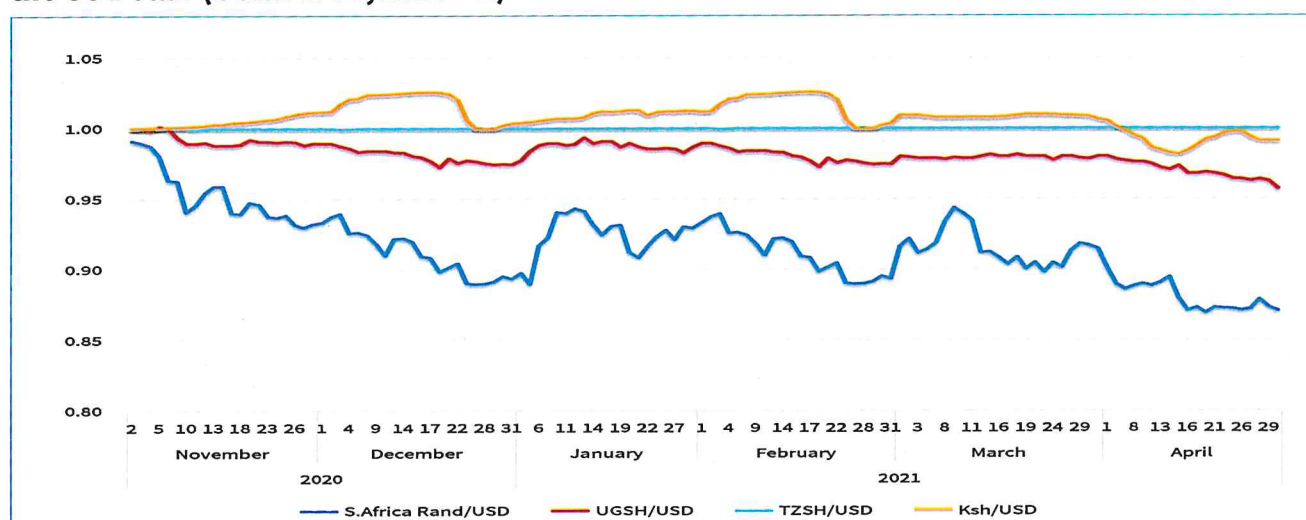
2.3.2 Foreign Exchange Market Developments

The foreign exchange market remained steady in the six months to April 2021, owing to improved inflows from selected exports, strong diaspora remittances and relatively lower imports. However, due to substantial strengthening of the US Dollar(USD) in global markets following improvements in growth outlook and inflation expectations, the foreign exchange market faced temporary pressures in March. The exchange

rate stabilized in April as a result of significant inflows (Chart 3a and 3b). Remittance inflows in the 12 months to April 2021 totalled USD 3,342 million compared to USD 2,824 million in the same period in 2020, a 18.3 percent increase.

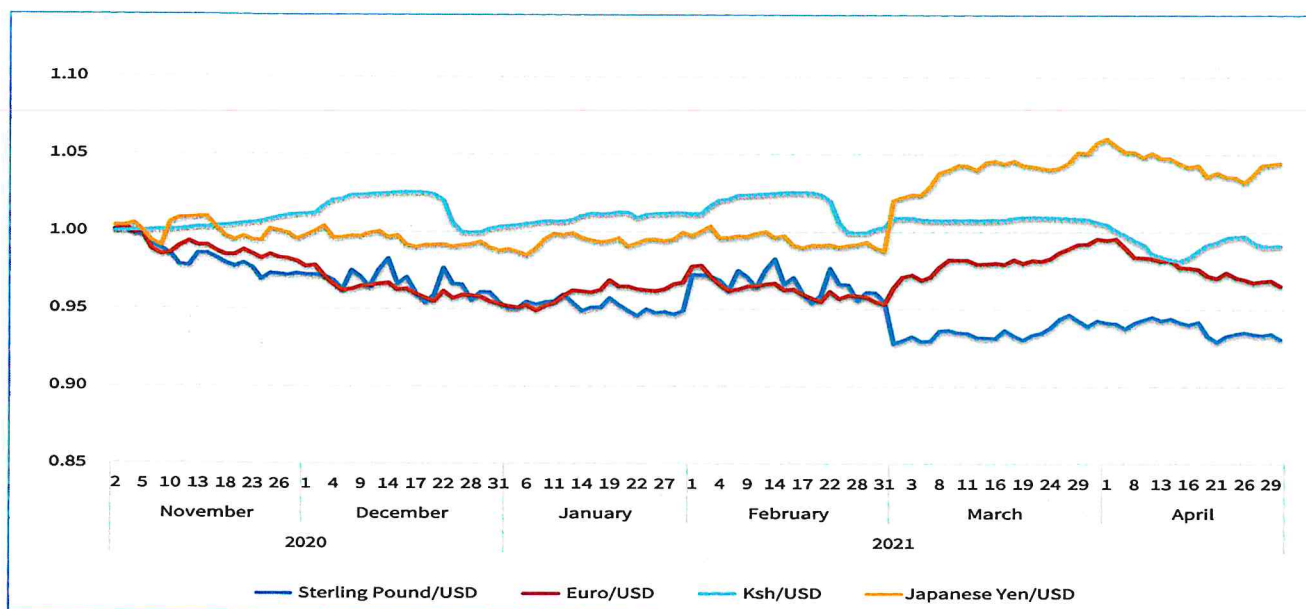
CBK foreign exchange reserves remained above the statutory minimum of 4 months of import cover. The reserves stood at USD 7,628.4 million (4.69 months of import cover) in April 2021. The reserves continued to provide adequate cover and a buffer against short-term

Chart 3a: Normalized Exchange Rates of the Kenya Shilling and Regional Currencies against the US Dollar (October 30, 2020 = 1)



Source: Central Bank of Kenya

Chart 3b: Normalized Exchange Rates of the Kenya Shilling and Major Currencies against the US Dollar (October 30, 2020 = 1)



Source: Central Bank of Kenya

shocks in the foreign exchange market. The approval on April 2, 2021 of a new program with the IMF under the ECF and EFF arrangements, indicates confidence in the country's macroeconomic policies and will provide an additional buffer against short term shocks.

2.3.3 Balance of Payments Developments

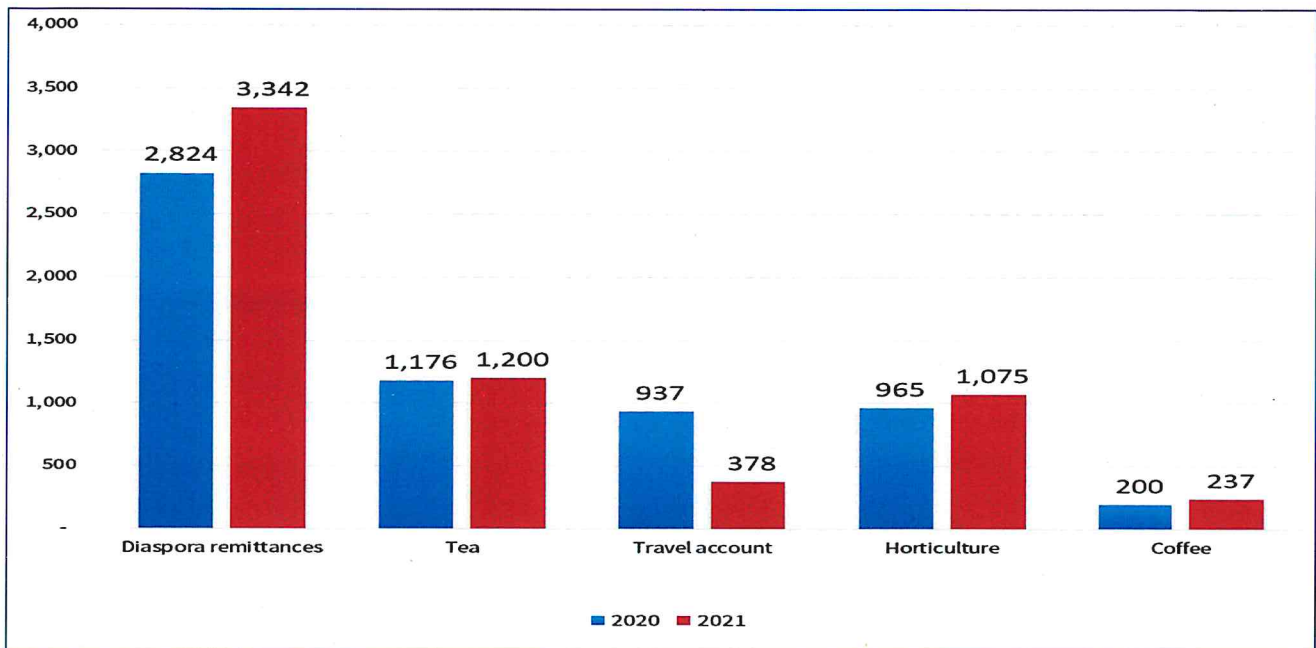
In the 12-months to April 2021, the current account balance was a deficit of USD 5,067.2 million (5.2 percent of GDP), compared to a deficit of USD 5,688.7 million (5.6 percent of GDP) in a similar period in 2020. The narrowing of the current account deficit was primarily due to resilient exports of merchandise goods coupled with a reduction in imports despite the subdued performance of service exports.

The value of merchandise exports remained stable at USD 6,176.6 million in the 12-months to April 2021 compared with USD 5,992.6 million in the 12-months to April 2020. Exports of tea and horticulture increased by 2.1 percent and 11.4 percent, respectively, whereas those of re-exports declined by 27.3 percent. Merchandise imports fell to USD 15,145.9 million in the year to April 2021, from USD 16,150.4 million in the

previous year. The decline in imports was mainly driven by reduced imports of petroleum products, which fell by 29.1 percent partly on account of lower global oil prices. Services exports declined by 30.6 percent in the 12-months to April 2021 due to a 45.2 percent and 59.5 percent drop in earnings from transportation and travel services, respectively. The decline in services exports, especially tourism, was attributed to COVID-19 related disruptions to international air and travel (**Chart 4a and Chart 4b**).

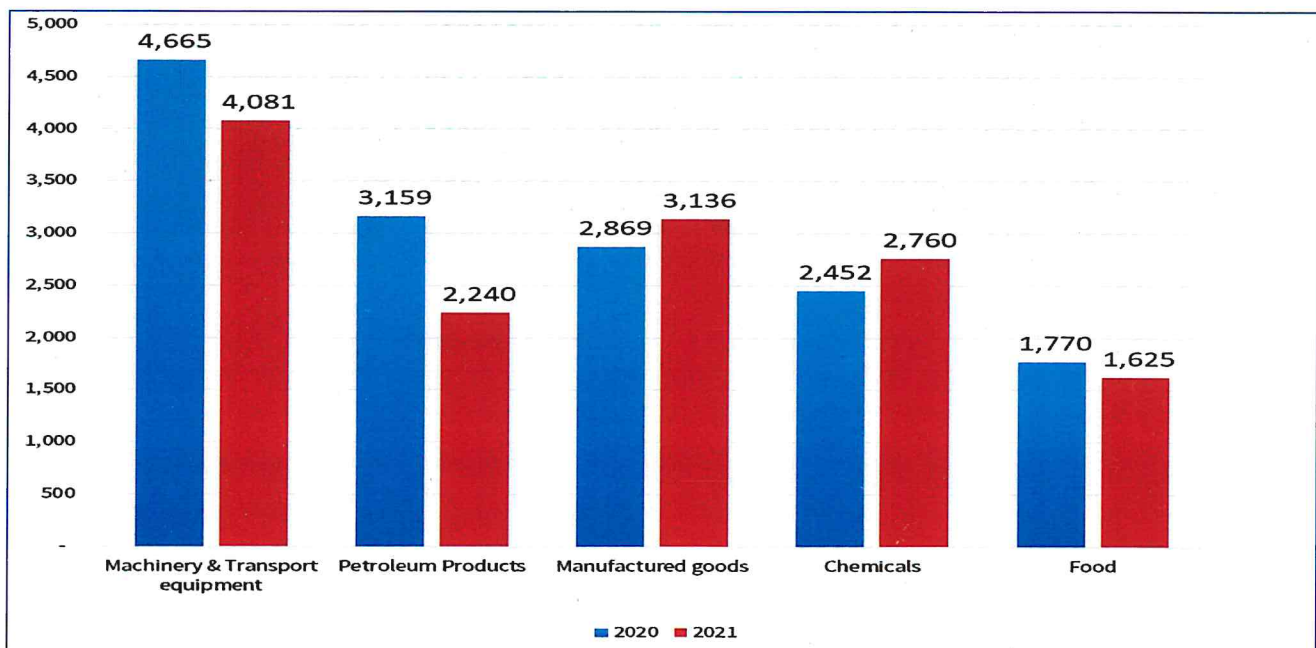
Financial account net inflows totalled USD 3,918.2 million in the 12-months to April 2021 from USD 5,727.1 million over a similar period in 2020. This largely reflected a reduction in foreign direct investment (FDI) liabilities and a slowdown in other investment inflows despite the increase in external inflows to Government. The capital account on the other hand, recorded a surplus of USD 268.2 million in the 12-months to April 2021, owing to consistent inflows of Government grants. Imports from China accounted for 24.3 percent of the total imports in the 12 months to April 2021, while India, the United States, and the United Kingdom accounted for 11.6 percent, 3.7 percent, and 1.9 percent, respectively.

Chart 4a: Foreign Exchange Inflows from Major Export Categories in the 12-Months to April (USD Million)



Source: Kenya National Bureau of Statistic, Kenya Revenue Authority and Central Bank of Kenya

Chart 4b: Imports by Major Categories in the 12-Months to April (USD Million)



Source: Kenya National Bureau of Statistic, Kenya Revenue Authority and Central Bank of Kenya

Exports to Africa accounted for 40.5 percent of total exports over the same period, while exports to other trading blocs such as the EAC, COMESA, and the EU accounted for 25.0 percent, 28.5 percent, and 23.9 percent, respectively.

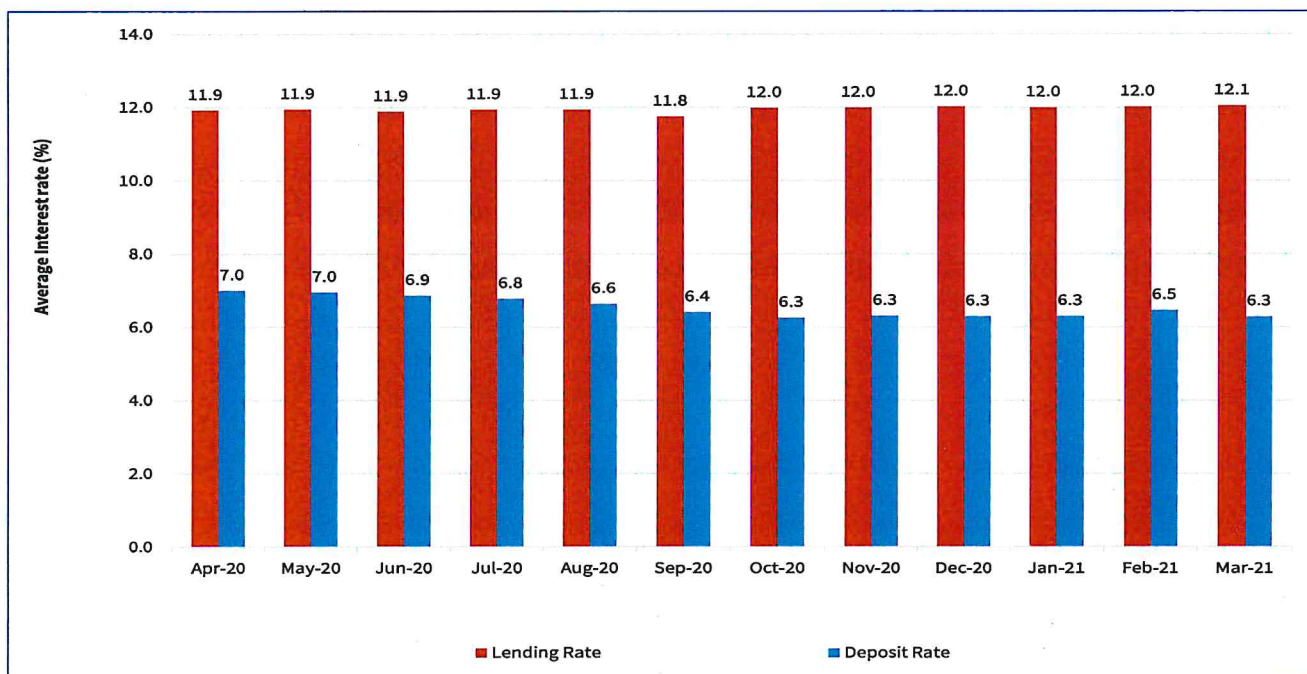
2.3.4 Banking Sector Developments

The banking sector remained stable and resilient, with strong liquidity and capital adequacy ratios. The average commercial banks liquidity increased to 56.5 percent in April from 53.3 percent in October 2020, driven by higher increases in treasury bonds and balances with foreign banks, while the capital adequacy ratios increased to 18.6 percent from 17.6 over the same

period. The ratio of gross non-performing loans (NPLs) to gross loans stood at 14.2 percent in April compared to 13.6 percent in October 2020. NPL increases were noted in the real estate, agriculture, personal and household, and manufacturing sectors. The increase in NPLs was attributable to the subdued business environment, and banks continue to make appropriate provisions for the NPLs.

With regard to interest rates, commercial banks average lending rate remained relatively stable at about 12 percent, reflecting accommodative monetary policy stance. Similarly, the average commercial banks deposit rate was stable at about 6.4 percent (**Chart 5**).

Chart 5: Commercial Banks Average Interest Rates(%)



Source: Central Bank of Kenya

2.3.5 Developments in Private Sector Credit

Private sector credit growth remained resilient in the six months to April 2021, supported by an accommodative monetary policy stance and improved economic activity. Growth in private sector credit stood at 9.7 percent and 6.8 percent in the 12-months to February and April 2021, respectively, with significant loan repayments and recoveries in March and April. In

April 2021, strong credit growth was observed in the following sectors: transport and communications (13.3 percent), agriculture (10.0 percent), finance and insurance (7.6 percent), and consumer durables (19.3 percent) (**Table 1**). The moderation in credit growth also reflect strong credit demand in March and April 2020 from manufactures of fast-moving consumer goods and COVID-19 related products. The food and beverage manufacturers remained the largest

Table 1: 12-Month Growth in Private Sector Credit (%)

	Dec-19	Mar-20	Jun-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21
Total Credit to Private Sector	7.1	8.9	7.7	7.6	7.7	8.1	8.4	9.3	9.7	7.7	6.8
Agriculture	-2.4	1.4	2.2	1.7	17.0	19.3	15.3	15.6	13.4	12.3	10.0
Manufacturing	9.2	15.3	11.1	12.6	7.8	10.0	12.0	12.6	15.8	10.7	4.0
Trade	8.9	9.4	9.4	6.6	2.5	4.0	3.8	5.5	3.9	2.1	0.9
Building & construction	1.6	9.5	4.6	4.1	8.2	7.4	3.4	2.5	5.2	2.9	3.4
Transport & communication	8.1	7.1	14.9	20.6	21.1	17.5	13.6	14.4	19.0	17.4	13.3
Finance and insurance	0.4	6.6	3.2	-3.3	-2.2	0.2	7.1	14.0	9.0	7.5	7.6
Real estate	1.5	2.2	4.9	6.6	7.6	9.1	8.7	8.8	8.8	7.7	5.8
Mining & quarrying	-5.8	3.9	10.0	8.2	-14.2	-15.4	-12.9	-6.1	21.6	-3.6	-8.8
Private households	5.6	3.4	3.6	3.5	7.3	6.2	4.3	5.2	4.6	3.4	4.9
Consumer durables	26.0	24.1	15.2	15.6	15.7	18.8	18.1	18.7	20.3	17.6	19.3
Business services	2.4	3.3	5.3	4.1	5.9	2.7	4.0	6.5	5.0	5.7	7.2
Other activities	16.0	36.8	-3.7	-5.8	-10.4	-14.5	14.0	5.8	3.8	5.2	24.3

Source: Central Bank of Kenya

recipients of bank lending to manufacturing sector, accounting for 34.4 percent of the sector's credit during the review period. Growth of credit to the private sector is expected to remain strong on account of previous policy measures, operationalization of the Credit Guarantee Scheme targeting Micro, Small and Medium-sized Enterprises (MSMEs) that de-risk lending by commercial banks, and continued economic recovery.

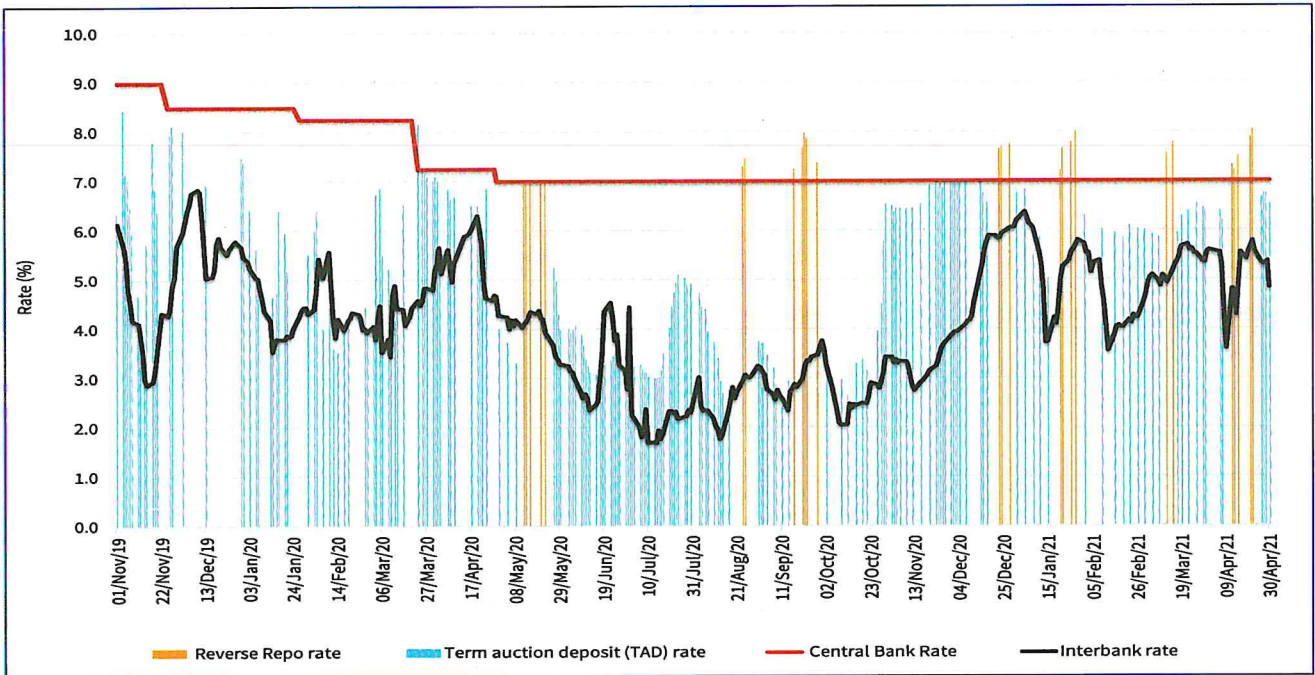
2.3.6 Interest Rates

During the six months to April 2021, the MPC retained the Central Bank Rate (CBR) at 7.00 percent. The Committee noted that the policy package deployed since March 2020 was having the intended effect on the economy, augmented by implementation of the

announced fiscal measures in the FY2020/21 Budget. Interest rates generally remained stable, supported by accommodative monetary policy stance. The short-term interest rates remained below the CBR, partly reflecting ample liquidity conditions in the market. Liquidity management operations by the CBK continued to ensure stability in the market (**Chart 6a**).

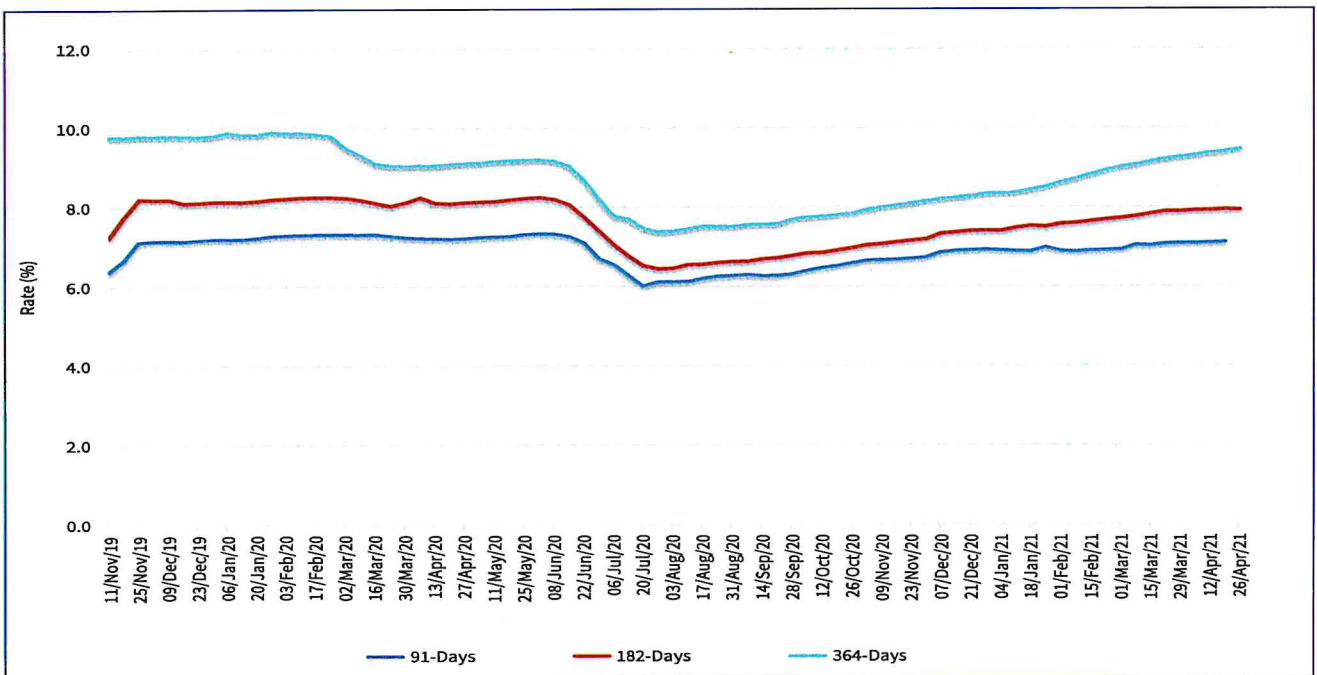
Similarly, interest rates on Government securities were generally stable in the six months to April 2021 (**Chart 6b**). The stability in the yield curve for Government securities during the period reflected ample liquidity in the money market as well as effective coordination of monetary and fiscal policies, particularly in the implementation of the Government domestic borrowing programme (**Chart 6c**).

Chart 6a: Trends in Short Term Interest Rates (%)



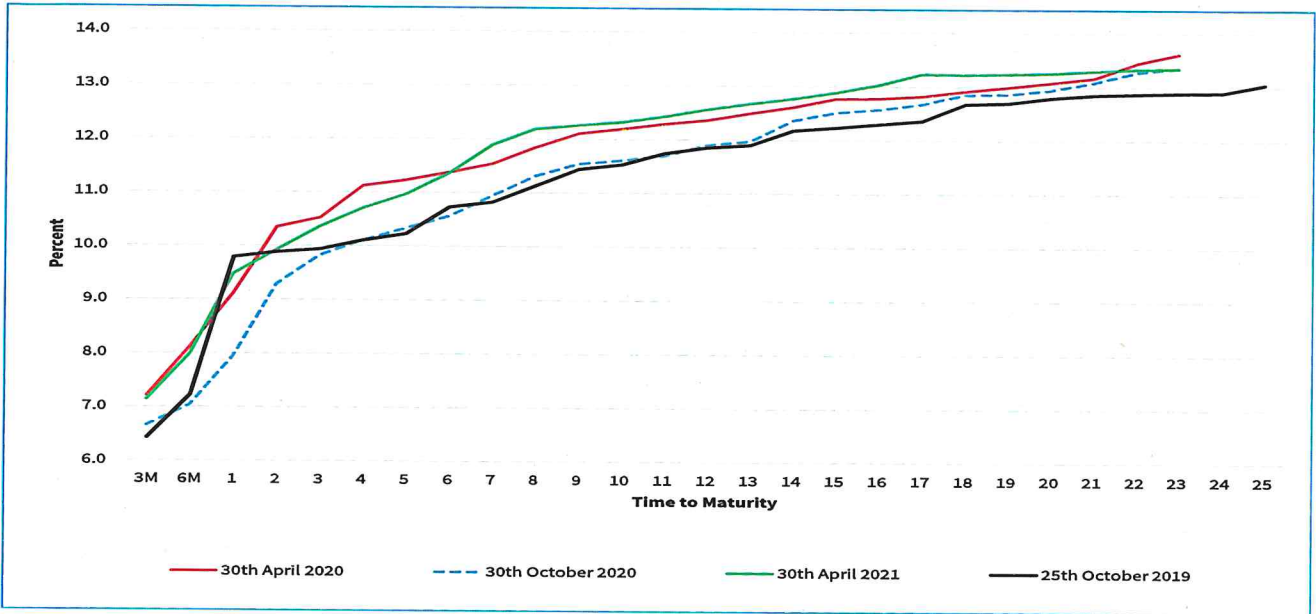
Source: Central Bank of Kenya

Chart 6b: Interest Rates on Treasury Bills (%)



Source: Central Bank of Kenya

Chart 6c: Government Securities Yield Curve



Source: Central Bank of Kenya

3. MONETARY POLICY FORMULATION

3.1 Attainment of Monetary Policy Objectives and Targets

During the six months to April 2021, the MPC formulated monetary policy to achieve and maintain overall inflation within the target range as provided by the Cabinet Secretary for the National Treasury and Planning at the beginning of FY2020/21. The inflation target for the medium term was 5 percent with an allowable margin of 2.5 percent on either side.

The Central Bank Rate (CBR), which was the main signal of the stance of monetary policy, remained the base for all monetary policy operations. The policy stance was operationalised through various instruments including: Open Market Operations (OMO), and the CBK Standing Facility (Overnight Discount Window which is a lender of last resort facility). To achieve the desired level of money supply and to support efficient distribution of liquidity in the interbank market, OMO was conducted using Repurchase Agreements (Repos), Term Auction Deposits (TAD) and Reverse Repos.

During the period, overall inflation remained well anchored within the medium-term target band, supported by low food prices and subdued demand. The 12-month inflation rate stood at 5.8 percent in April compared to 4.8 percent in October 2020, while the non-food-non-fuel (NFNF) inflation remained below 5 percent. In addition, the annual growth in the broad money (M3) and private sector credit remained within their projected growth paths. In particular, the 12-month growth in M3 stood at 9.3 percent in April 2021 compared to 11.5 percent in October 2020. The main sources of money supply growth were continued recovery in private sector credit and net lending to Government.

3.2 Monetary Policy Committee Meetings and Decisions

Over the six months to April 2021, the MPC held meetings on November 26, January 27 and March 29. These meetings were preceded by technical meetings. MPC meetings were held against a backdrop of the continuing global COVID-19 (coronavirus) pandemic, measures taken by authorities around the world to

contain its spread and impact, and the rollout of vaccination programmes. The meetings considered the implications of the various measures implemented by the Government and assessed outcomes of its policy measures deployed since March 2020 to mitigate the adverse economic effects and financial disruptions from the pandemic.

In the November meeting, the MPC noted that the global economic outlook for 2020 remained highly uncertain and the pace of recovery of the global economy in the second half had been dampened by the re-introduction of containment measures in some advanced economies following a resurgence in COVID-19 infections. However, global business sentiment had improved with announcements of COVID-19 vaccines, and the conclusion of the U.S. elections. Inflation was expected to remain well anchored within the target range, supported by lower food prices and muted demand pressures. Growth in the private sector credit remained resilient and exports of goods, particularly horticulture, continued to strength with the normalisation of demand in the international markets and the availability of adequate cargo space. The MPC retained the CBR at 7.00 percent, noting that the package of policy measures implemented since March were having the intended effect on the economy, augmented by implementation of the announced fiscal measures in the FY2020/21 Budget.

The January meeting was held at a time of positive prospects from the availability of vaccines. The global economy was expected to grow by 5.5 percent in 2021, from a contraction of 3.5 percent in 2020, supported by the rollout of COVID-19 vaccination programmes and additional policy measures particularly in the U.S. This was despite uncertainty partly due to the emergence of new variants of the virus and the reintroduction of containment measures in some economies. Inflation was expected to remain well anchored due to lower food prices and muted demand pressures, despite the impact of the recently introduced tax measures. In addition, the MPC assessed that the recovery of the Kenyan economy in the fourth quarter of 2020 was expected to continue in 2021 with the recovery in the services sectors particularly education, manufacturing, resilient agriculture and the ongoing policy support

through the Government's economic recovery plan. The Committee noted that the package of policy measures deployed since March 2020 were having the intended effect on the economy, augmented by implementation of the announced fiscal measures in the FY2020/21 Budget. The Committee concluded that the accommodative policy stance remained appropriate and retained the CBR at 7.00 percent.

The March meeting was held in the context of the continuing global COVID-19 pandemic, rollout of vaccination programmes, and other measures taken by authorities around the world to contain its spread and impact. Global economic prospects had improved largely on account of the deployment of vaccines and strong policy measures, but the outlook remained highly uncertain due to concerns on the pace of rollout of vaccination programmes, the emergence of new variants, and reintroduction of containment measures in some economies. The inflation rate was expected to remain within the target range supported by lower food prices and muted demand pressures, despite the recent increase in fuel prices. In addition, the domestic economy was expected to rebound strongly in 2021, supported by recovery in

the services sector particularly education and the wholesale and retail trade. The recovery was anchored on the success of the containment measures and the vaccination programme. Exports of goods continued to strengthen, private sector credit remained resilient and optimism on economic growth prospects in 2021 remained strong attributed to the rollout of COVID-19 vaccines, the stable economic environment, increased Government spending on infrastructure, and the COVID-19 mitigation measures. The Committee noted that the package of policy measures implemented over the last year had protected the economy from substantial decline, and supported the most vulnerable citizens. The MPC concluded that the current accommodative monetary policy stance remained appropriate, and decided to retain the CBR at 7.00 percent.

During the six months to April 2021, the MPC surveys were expanded to cover more regions and sectors of the economy. These surveys enhanced the information set for the MPC decisions. Additionally, The National Treasury continued to provide the MPC with information on the Government budget implementation during the MPC meetings.

4. IMPACT OF POLICY RESPONSES TO COVID-19 (CORONAVIRUS) PANDEMIC

During the six months to April 2021, the MPC closely monitored the outcomes of the policy and emergency measures deployed, at the onset of the COVID-19 pandemic in March 2020, to mitigate the anticipated adverse economic effects and financial disruptions from the pandemic. These measures were intended to provide liquidity to the banking sector, mitigate the adverse impact on bank borrowers and facilitate the use of mobile money. An assessment by the Committee showed that these measures protected the economy from substantial decline, and supported the most vulnerable citizens. In particular, the measures ensured continued provision of financial services and provided a buffer against a more adverse impact on the economy. Specific outcomes are highlighted below.

Interest rates remained low and stable supported by the accommodative monetary policy and improved liquidity conditions. As a result, private sector credit growth continued to strengthen benefiting key sectors of the economy particularly manufacturing, transport and communications, agriculture, real estate and consumer durables. The operationalisation of the Credit Guarantee Scheme (CGS), in October 2020, is expected to de-risk commercial banks' lending and support additional credit uptake by the vulnerable Micro Small and Medium-sized Enterprises (MSMEs). As at end April 2021, all the seven approved banks had started lending under the Scheme, with total loans disbursed amounting to KSh 296.4 million.

The lowering of the Cash Reserve Ratio (CRR) in March 2020 had, by March 2021, injected KSh 32.8 billion to support lending to Tourism (31.8 percent), Trade (14.8 percent), Transport and Communication (13.9 percent), Real Estate (12.6 percent), Manufacturing (12.1 percent), and Agriculture (10.0 percent).

In line with the emergency measures announced by CBK on March 18, 2020 to provide relief to borrowers, loans amounting to KSh1.7 trillion (54.8 percent of total

gross loans) were restructured as by end April. The outstanding restructured loans as at end February 2021 amounted to KSh 521.1 billion (16.9 percent of the total gross loans). These measures, which expired on March 2, 2021, provided the intended relief to borrowers, supported continued operation of business including essential sectors – manufacturing, trade, and transport and communication, and mitigated more severe loss of jobs and livelihoods. Additionally, the measures provided space for the banking sector to build capital and liquidity buffers, thereby strengthening resilience of the sector.

On June 24, 2020, CBK extended the mobile money emergency measures to end of the year to mitigate against the continued impact of COVID-19 pandemic. This measure resulted in an increase in volumes and values of low value transfers between bank and mobile e-wallets indicating a gradual shift towards digital platforms and less utilisation of physical access channels. Transactions outside bank branches rose to over 96 percent from 91.7 percent before the pandemic. Mobile phone transactions as a share of total transactions increased significantly from 55.7 percent to 79.6 percent while the value of transactions increased from 8.5 percent to 17.3 percent of total value of transactions. The number and value of transactions through digital channels (mobile phone and internet) increased from 57.7 percent and 26.9 percent to 81.5 percent and 38.6 percent, respectively.

On the fiscal front, the Government continued to implement programmes to cushion citizens and businesses from the effects of the COVID-19 under the Economic Stimulus Programme. Revenues began to gradually improve in the second half of FY 2020/21 following reopening of the economy and implementation of tax reversals and tax measures in Finance Act, 2020. The VAT adjustment in January 2021 had a mild impact on inflation.

5. OTHER ACTIVITIES OF THE MONETARY POLICY COMMITTEE

The MPC continued to improve on the scope and information gathering processes through Surveys, and communication with key stakeholders to obtain feedback on its decisions. The results of the November, January and March Private Sector Market Perceptions Survey and Surveys of Hotels and Flower Farms provided important input in the monetary policy decisions in the period. The coverage of the Surveys encompassed respondents across the different regions of the country, particularly those around the CBK branches in Nairobi, Mombasa, Kisumu and Eldoret, and Currency Centres in Nakuru, Nyeri, Meru and Kisii. The Survey instruments were modified to allow continuous capturing of information on key sectors of the economy affected by the COVID-19 pandemic. The Reports were disseminated through the CBK website for wider public readership and received significant media coverage.

In March 2021, the CBK introduced a CEOs Survey with the objective of capturing information on top firms' perceptions, expectations and decisions and supporting key policy decisions, including monetary policy. The Survey sought CEOs views on selected indicators including business confidence/optimism, previous quarter business activity, and business activity outlook in the near term. The Survey also sought to establish the key internal and external factors that could influence business outlook and strategic priorities over the medium-term. The Survey targeted CEOs of key private sector organizations including members of the Kenya Private Sector Alliance (KEPSA) and the Kenya Association of Manufacturers (KAM).

The Governor held virtual media briefings after MPC meetings to apprise the media on the background to the MPC decisions. In addition, the MPC members held virtual meetings with the Chief Executives of commercial banks and private sector firms after MPC meetings in order to apprise them on the background to its decisions.

The MPC Chairman also held virtual meetings with various potential investors to brief them on economic developments and the outlook for the economy. The Committee monitored the implementation of the Committee's policy decisions by the Monetary Policy Management Committee of the Bank, and continued to interact with other government agencies such as the National Treasury, Kenya National Bureau of Statistics (KNBS), and Kenya Tourism Board (KTB) on various policy and data issues.

The MPC held a Retreat on March 5 to discuss strengthening of the monetary policy framework (MPF). During the Retreat, the MPC reviewed: experiences of other countries on the MPFs; Report of the Technical Assistance (TA) Mission on Kenya's monetary policy design and implementation; and, issues to be addressed in the White Paper on strengthening of the monetary policy framework and operations.

6. CONCLUSION

The monetary policy measures adopted by the MPC in the six months to April 2021 continued to support price stability, while also providing support to households and businesses in mitigating the adverse impact of the pandemic. The stability of the exchange rate continued to moderate any possible distortions that imported inflation would have had on the stability of domestic prices. The continued coordination of fiscal and monetary policies during the period also supported the achievement of price and market stability.

The MPC will also continue to implement measures towards strengthening the monetary policy framework.

The CBK will continue to closely monitor the impact of the policy measures, as well as developments in the global and domestic economy that might impact the price stability objective. The CBK will also continue to explore and implement measures aimed at promoting the efficiency of the money markets, improve the conduct of liquidity management and adopt measures to support access and affordability of credit to the private sector, particularly the MSMEs.

ANNEX

EVENTS OF PARTICULAR RELEVANCE TO MONETARY POLICY (NOVEMBER 2020-APRIL 2021)

Date	Event of Relevance to Monetary Policy
November 2020	The MPC retained the CBR at 7.00 percent. The Committee noted that the package of policy measures implemented since March were having the intended effect on the economy, augmented by the implementation of the measures in the FY2020/21 Budget.
December 2020	Expiry of emergency measures to facilitate mobile money transactions
	Introduction of principles to guide pricing of mobile money transactions aimed at supporting the development of an efficient, safe and stable payments and mobile money ecosystem where the customer and public interests are adequately protected
January 2021	Withdrawal (effective January 1) of temporary tax relief measures introduced in April 2020 to cushion businesses and individuals against impact of COVID-19
	The MPC retained the Central Bank Rate (CBR) at 7.00 percent. The Committee noted that the package of policy measures implemented since March 2020 were having the intended effect on the economy, augmented by implementation of the announced fiscal measures in the FY2020/21 Budget.
March 2021	The CBR retained at 7.00 percent. The Committee noted that the package of policy measures implemented over the last year had protected the economy from substantial decline, and supported the most vulnerable citizens.
	Resurgence of the third wave of the COVID-19 infections leading to reintroduction of stringent measures to help curb its spread.
	Re-introduction or extension of lockdown measures in Europe in response to third wave of the COVID-19 infections particularly in key export markets for horticulture and flowers.
April 2021	Kenya entered into a 38-month program with the IMF under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) arrangements. The program will support Government's next phase of COVID-19 response; stabilise debt to GDP ratio and lay the ground for durable and inclusive growth.
	Release of April 2021 IMF WEO report showing stronger projections for 2021 and 2022 relative to October 2020 WEO. This reflects additional fiscal support in a few large economies, the anticipated vaccine-powered recovery in the second half of 2021, and continued adaptation of economic activity to subdued mobility.

GLOSSARY OF KEY TERMS

Overall Inflation: This is a measure of inflation in the economy measured by the month-on-month movement of indices of all consumer price items of goods and services sampled by the KNBS. It is affected by commodity components in the market that may experience sudden inflationary spikes such as food or energy.

Reserve Money: These are CBK's monetary liabilities comprising currency in circulation (currency outside banks and cash held by commercial banks in their tills) and deposits of both commercial banks and non-bank financial institutions held with the CBK. It excludes Government deposits.

Money Supply: Money supply is the sum of currency outside banks and deposit liabilities of commercial banks. Deposit liabilities are defined in narrower and broader terms as follows: narrow money (M1); broad money (M2); and extended broad money (M3). These aggregates are defined as follows:

- M1: Currency outside banking system + demand deposits
- M2: M1 + time and savings deposits + certificates of deposits + deposit Liabilities of Non-Bank Financial Institutions (NBFIs)
- M3: M2 + residents' foreign currency deposits

Central Bank Rate (CBR): This is the lowest rate of interest that the CBK charges on overnight loans to commercial banks. It is reviewed and announced by the Monetary Policy Committee at least every two months as part of its decisions. It is used by the commercial banks as a reference interest rate hence transmits to the financial sector and signals the CBK's monetary policy stance.

Cash Ratio Requirement (CRR): This is the ratio of deposits of commercial banks and non-bank financial institutions maintained with the CBK (as reserves) to commercial banks total deposit liabilities. The ratio is fixed by CBK as provided for by the law.

CBK Discount Window: The CBK Discount Window is a collateralized facility of last resort for banks. It has

restrictive guidelines controlling access. The Discount Window plays a significant role in ensuring banking sector stability by offering overnight liquidity as a last resort. It is anchored on the CBR with a prescribed penalty.

Open Market Operations (OMO): The act of buying or selling of government securities from or to commercial banks by the Central Bank in order to achieve a desired level of bank reserves. OMO is carried out in the context of an auction where commercial banks bid through the Reuters dealing system or by phone/fax.

Repurchase Agreement (Repo): Repos/reverse repos are agreements between the CBK and commercial banks to purchase/sell Government securities from/to commercial banks at agreed interest rates (REPO rate) for a specified period with an understanding that the commercial bank will repurchase/resell the security from/to the CBK at the end of the period. The period can be varied by the CBK.

Term Auction Deposits (TAD): The TAD is used in exceptional market conditions when the securities held by the CBK for Repo purposes are exhausted or when CBK considers it desirable to offer longer tenor options. The CBK seeks to acquire deposits through a transfer agreement from commercial banks at an auction price but with no exchange of security guarantee.

Horizontal Repo: This is an interbank Repo instrument which recognises Government securities as collateral for borrowing. The instrument has a variable tenor and allows commercial banks without credit lines with other banks to access credit from the interbank market.

Interbank Market: The interbank market is a critical channel for distributing liquidity that reduces the need for banks to access the CBK Overnight Discount Window. However, since not all banks have credit lines with each other, it is not a perfectly operating market and therefore banks may come to the Window as a last resort. The interest rates charged by banks reflect an individual bank's perception of the risk of the particular bank borrower and also the tightening liquidity in the market.



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